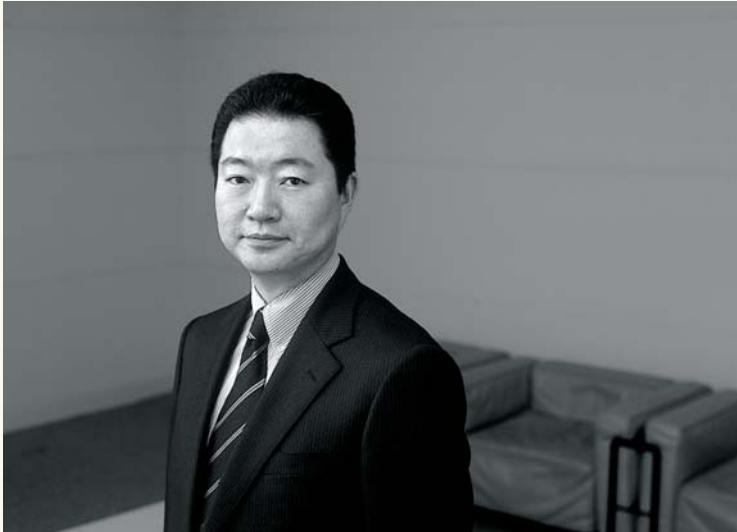


To Our Shareholders



President and Representative Director

Yoichi Wada

Square Enix Co., Ltd. is proud to present its first annual report for fiscal 2003, ended March 31, 2004, following the merger of Enix Corporation and Square Co., Ltd. on April 1, 2003.

For its first fiscal year, consolidated net sales totaled ¥63,202 million, operating income was ¥19,398 million and net income amounted to ¥10,993 million for an operating income margin of 30.7% and return on equity (ROE) of 11.9%. Compared against the simple addition of the historical figures of the former Enix Corporation and Square Co., Ltd., performance in fiscal 2003 reached a record high. Square Enix got an excellent start to its new journey owing to the smooth integration of the two companies following the merger.

The Square Enix Group aims to become one of the world's largest and best digital content providers. While our performance during the fiscal year under review was encouraging, we believe it was nothing more than a start of what is to come. Here, we would

like to discuss our vision, perception of the operating environment and future management strategies.

A Fundamental Industry Change from Evolution in Network Technology

One factor why we decided on the merger was the major changes underway in the video game industry.

The structure of the IT industry in general has been changing from a vertically integrated to a horizontally linked industry—the typical example is the PC industry. Being part of the increasingly horizontally linked IT industry the video game business has been in the rare position of being able to maintain a vertically integrated business model. We believe that this atypical position was possible due to the unique capability of game consoles to make unique entertainment experiences possible—experiences that other hardware and software vendors were unable to provide on other platforms. We also believe that it was possible due to

> **Network** is the **Game**.
Everything plays **Games**.

market growth that kept profits well distributed within the industry value chain.

However, these conditions have changed.

For hardware vendors, this change was embodied by the ability of PCs, and in the near future mobile phones, to match the unique features of game consoles, which had lost their lead in graphics rendering capabilities. Game consoles were also behind PCs in incorporating networking functions, an indispensable competitive feature in the new industry structure. For software vendors, this change represented an increase in development costs to accommodate much improved hardware specifications and technical difficulties in transferring game software to other media. For customers, this change meant the emergence of markets for new digital content beyond video games. All of these changes collided together in the game industry. The strength of having a vertically integrated business model began to become a weakness, because there were

few companies, other than console providers, which were large enough to weather downward pricing pressure and so the market grew too large for console providers to keep pace.

At a glance, this might appear to be a problem unique to Japan, but we believe it applies in global markets as well. These conditions are not reflected outside Japan yet owing to differences in the timing of game console proliferation in Japan and other countries, as well as differences in the distribution structure. Even if the aforementioned change did not occur, the real issue at hand is advancements in network technology. Open networks disrupt vertically integrated business models, and this is not something unique to Japan.

The video game industry is changing from a vertically integrated model to a horizontally linked one, and customer ownership is shifting from game console manufacturers to content providers.

A New Era of Entertainment

Another factor why we decided on the merger was to tackle a massive new market.

Taking another look at changes in the industry structure, we see that the process of change is offering customers new forms of entertainment. Companies unable to adjust to this change will fail, and companies that precisely adapt to this change will be offered incredible business opportunities.

Square Enix expresses the new era of networking in the following two catchphrases.

“Network is the Game”

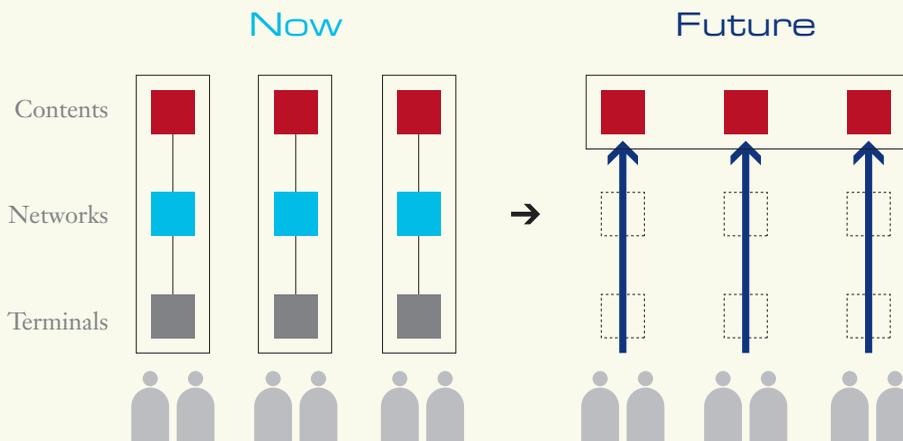
Network is the Game is our way of expressing the fact that communication across networks is an essential element in new network-based interactive content. To

think abstractly, it can be said that a game is a form of communication based on a set of rules. The enjoyment derived from a game of chess or sports is created through interaction between people. Technology has advanced to the point of allowing users to enjoy communicating through virtual worlds. Demand for communications, and the communities that naturally formed as a result, present an unlimited market restricted only by the whims of people.

“Everything Plays Games”

With the advancement of multifunctional, high-performance platforms, the way users access content is diversifying. Users will be able to access the same content at any time no matter where they are, and they will be able to access various kinds of content from a single platform.

Networks will transform the Entertainment Industry.



In any case, we believe users stand to benefit no matter what happens next in the coming era of network gaming.

It is our view that these developments are occurring in not only the TV gaming industry, but also the IT industry as a whole.

Becoming the Largest and Finest Digital Content Provider

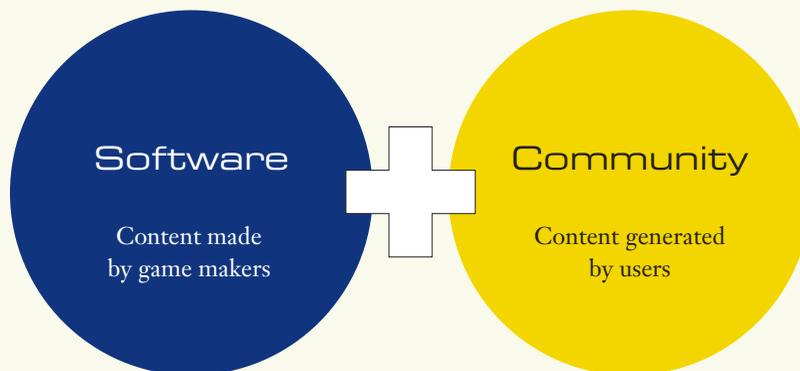
A noteworthy point about the video game industry is that it has increased the variety and quality of entertainment through technology. The video game industry is in the best position to take advantage of the technological changes mentioned above. To this end, we believe the mission of Square Enix is to lead the industry into a new era of entertainment.

To be able to adapt to any industry structure, more specifically, to take the initiative in designing the next ecosystem, Square Enix must have influence over the whole value chain, reinforce its financial capacity, and enhance its presence to form broad-ranging alliances.

The former Enix and Square were similar in terms of their commitment to the quality of their products, but they had different business models and different areas of business focus. As a result of the merger, the two companies were able to mutually complement these differences and achieve the above-mentioned objectives in a short time.

In addition, both companies share a point in common in that they were early to start initiatives in network content and we believe this will become a crucial cornerstone for our future growth, despite the fact that both companies' preeminence in packaged

Network is the Game.



software tended to overshadow their efforts on the online games front.

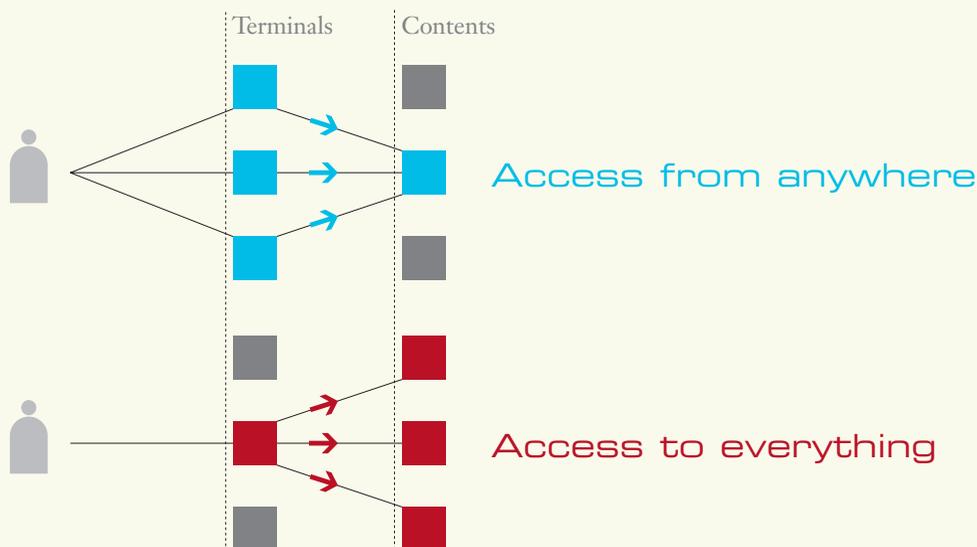
What is Square Enix's strategy in this challenging but exciting business environment? We think the following three actions are critical: enhance community management; deploy polymorphic content; and define new platforms.

Network content is comprised of two elements, namely software and communities. Communities are a previously nonexistent service category, and managing the quality of these communities is an area where we can add the most value going forward. Communities provide the most value to users, and managing them is the most difficult business area for providers to enter. For these very reasons, Square Enix plans to concentrate on enhancing community management skills.

Our next strategy is the development of polymorphic content. This entails the creation of original content with the intent of deployment across various platforms while leveraging the unique features of each platform and media type. Recently, there has been an industry trend toward creating games based on pre-existing content such as sports and movies. In other words, many games are created as a secondary usage of the original content for which others hold the intellectual property (IP) rights. We are focusing on capitalizing on our own IPs. As the "Everything Plays Games" trend continues, we expect profits will converge on the industry players, such as Square Enix, who possess the IP rights to original content.

Our third strategy is to define new platforms, yet this does not mean we intend to become a hardware manufacturer. As the industry shifts to a horizontally

Everything plays Games.



linked structure, Square Enix intends to develop a new relationship with various hardware and software companies to define new platforms that will be a combination of many technologies provided by the various industry players.

With regard to our medium-term outlook, we plan to lay the groundwork for earnings in fiscal 2004 and fiscal 2005 based on products currently in the pipeline. We expect an outline of the new industry structure to emerge in fiscal 2005 or fiscal 2006. Therefore, Square Enix has chosen the first two years as a period for reinforcing its business foundation and making forward-looking investments. As a part of these efforts, we enhanced our management and organization of overseas operations in the U.S., Europe and China, beginning in April 2004. In fiscal 2006, 2007 and 2008, we will take part in full-fledged competition within the

IT industry as a whole, and I have chosen these years as a time for expansion. By 2010, the Square Enix Group plans on becoming one of the largest and best digital content providers in the world and profiting from its endeavors.

We are now setting out on a new adventure. To this end, we ask for the steadfast support of our shareholders.

July 2004

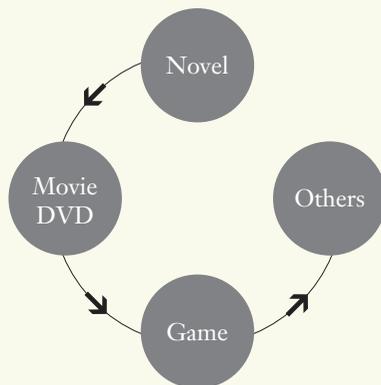


Yoichi Wada

President and Representative Director

Deploy "Polymorphic Content".

Traditional model of
Secondary use of
Content



"Polymorphic Content"

